

## **APPENDIX IX-1 EXCERPTS FROM CONSOLIDATED AUDIT GUIDE FOR AUDITORS OF HUD PROGRAMS (HANDBOOK No. IG 2000.04 REV.2)**

### **Applicability: Ginnie Mae I MBS Program and Ginnie Mae II MBS Program**

The Consolidated Audit Guide from which the attached excerpts are taken has not been updated to reflect the consolidation of the Ginnie Mae I MBS Guide, Handbook 5500.1, and the Ginnie Mae II MBS Guide, Handbook 5500.2, that was accomplished through the issuance of this Ginnie Mae MBS Guide, Handbook 5500.3 (this “Guide”).

Information ascribed to Chapter 2 of Handbook 5500.1 and Chapter 3 of Handbook 5500.2 in paragraphs f. and b. on page 25 of the attached Excerpts can now be found in Chapters 2 and 3 of this Guide.

Information ascribed to Chapters 2 and 6 of Handbook 5500.1 and Chapter 3 of Handbook 5500.2 in paragraph c. on page 25 of the attached Excerpts can now be found in Chapter 3 of this Guide.

Information ascribed to “Chapter 3 of the Ginnie Mae Guide, Standards for Document Custodians,” in the third paragraph under C.1. on page 27 of the attached Excerpts can now be found in Chapter 2 of Ginnie Mae Mortgage-Backed Securities Program — Document Custodian Manual, which is Appendix V-1 of this Guide.

Information ascribed to Paragraph 8-4 and Appendix 77 of Handbook 5500.1 and Paragraph 7-5 and Appendix 53 of Handbook 5500.2 in paragraph e. on page 30 of the attached Excerpts can now be found in Section 13-4 and Appendix V-1 of this Guide.

Information ascribed to Chapter 11 and Appendices 11 through 14 of Handbook 5500.1, in paragraph d., beginning on page 36 of the attached Excerpts, can now be found in Chapter 17 and Appendices VI-4, VI-5, VI-12, and VI-13 of this Guide.

Each other reference to “GNMA Handbook 5500.1 REV 6,” “GNMA Handbook 5500.2,” “5500.1, Rev. 6,” “5500.2,” “Handbook 5500.1,” and “Handbook 5500.2” shall be deemed to be a reference to this Guide. Each reference to “Ginnie Mae Handbooks” shall be construed as though it said “Ginnie Mae Handbook.”

**Table of Contents**

Chapter 1.	General Audit Guidance
Chapter 2.	Reporting Requirements and Sample Reports
Chapter 6.	Ginnie Mae Issuers of Mortgage-Backed Securities Audit Guidance

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## CHAPTER 1 - GENERAL AUDIT GUIDANCE

- 1-1 Purpose. This guide is to assist independent auditors (IAs) in performing program-specific audits of participants in selected Department of Housing and Urban Development (HUD) Housing and Ginnie Mae programs. These audits must be performed in accordance with the standards for financial audits of the U.S. General Accounting Office's (GAO) Government Auditing Standards, 1994 Revision, issued by the Comptroller General of the United States. The objectives of a HUD program-specific audit are to assist the program managers in HUD in determining whether the auditee has: (a) provided financial data and reports that can be relied upon; (b) internal controls in place to provide reasonable assurance that it is managing HUD programs in compliance with applicable laws and regulations; and (c) complied with the terms and conditions of Federal awards and guarantees, and thus expended Federal funds properly and with supporting documentation. This guide is effective for audits of fiscal years ending September 30, 1997 and thereafter.

HUD program audit reports are a primary tool used by program managers to meet their stewardship responsibilities in overseeing these HUD programs and assuring the integrity of the funds. The areas of noncompliance and internal control weaknesses noted in these reports must be acted upon by program managers. To be of value, these reports must contain adequate information to give reported matters perspective and to allow the managers to take necessary corrective action.

Use of this guide is mandatory for audits by IAs of all for profit participants in the HUD programs identified in paragraph 1-4. As of the issuance of this audit guide, HUD is developing regulations to implement OMB Circular A-133, effective June 30, 1997. It is anticipated that nonprofit institutions which own individual properties receiving HUD assistance under specified housing programs<sup>1</sup> will be required to complete project-specific audits because each project is deemed to be a separate entity. Those audits are to be conducted in accordance with OMB Circular A-133 and related guidance.

This guide is divided into chapters. The first chapter discusses purpose, background, audit planning and other considerations and establishes certain requirements for the performance of the audit. The second chapter contains the reporting requirements. The remaining chapters of the guide each contain a compliance supplement for a particular HUD program. Each audit should be conducted in accordance with requirements of Chapters 1 and 2 and the applicable compliance supplement included in Chapters 3 through 8 of this guide.

This guide is not intended to be a complete manual of procedures, nor is it intended to supplant the auditor's judgement of audit work required. Suggested audit procedures contained herein may not cover all circumstances or conditions encountered in a particular audit. The auditor should use professional judgement to tailor the procedures so that the audit objectives may be achieved. However, all applicable compliance requirements in this guide must be addressed by the auditor. If the auditor desires technical assistance pertaining to HUD programs, their regulations or operations, the auditor should contact the particular HUD Headquarters or Field

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<sup>1</sup>HUD programs whose regulations are set forth in 24 CFR parts 207, 213, 221, 232, 236, 242, 277, 880, 881, 883, 884, 885, 886, 889, and 890

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program office listed in the applicable chapter. A list of local and state offices is available on the Internet at [www.hud.gov](http://www.hud.gov).

- 1-2 **Auditor Qualifications.** An auditor must meet the auditor qualifications of Government Auditing Standards, including the qualifications relating to independence and continuing professional education. Additionally, the audit organization is to meet the quality control standards of Government Auditing Standards. While the Government Auditing Standards urge audit organizations to make their external quality control review reports available to appropriate oversight bodies, it is not necessary to submit the report to either the HUD Field Office or the HUD/OIG unless requested to do so.

The standards on auditor qualifications in the Government Auditing Standards require that accountants and accounting firms comply with the applicable provisions of the public accountancy laws and rules of the jurisdictions in which they are licensed and where the audit is being conducted. If the auditee is located in a State outside the home State of the auditor, and the auditor performs substantial fieldwork in the auditee's State, the auditor should document his/her compliance with public accountancy laws of that State regarding licensing, in the audit working papers. This guide does not impose additional licensing requirements beyond those established by the individual state board of accountancies (some states allow temporary practice without a license).

According to HUD Handbook 4370.2 REV-1, Chapter 3, IA's performing audits of mortgagors having HUD-insured or Secretary held multifamily mortgages must have no business relationship with the auditee except for the performance of the audit, accounting systems work, and tax preparation. Accordingly, for these audits, an individual who acts as the mortgagor's "fee accountant" (i.e., an individual who performs manual or automated bookkeeping services and/or maintains the official accounting records) is prohibited by HUD policy from performing the audit of that mortgagor. Also, according to HUD Handbook 4470.1 REV-2, Chapter 11, IAs performing cost certification audits of mortgagors or general contractors must have no business or financial relationship with the mortgagor or general contractor except for the performance of the audit.

- 1-3 **Audit Scope and Approach.** The audit should be sufficiently comprehensive in scope to permit an expression of an opinion on the financial statements and supplemental data of the HUD-assisted activity.

The opinion should state whether the basic financial statements present fairly, in all material respects, the financial position of the auditee as of the date of the financial statements and the results of its operations and its cash flows for the period then ended in conformity with generally accepted accounting principles. In addition, the opinion should state that the supplemental data has been subjected to the audit procedures applied in the audit of the basic financial statements and whether it is fairly stated in all material respects in relation to the financial statements taken as a whole.

The Government Auditing Standards require the IA to consider the auditee's internal controls as part of planning and performing the audit and report on internal controls. The auditor should report on internal controls in accordance with Chapter 2 of the guide.

Also, the IA is required to test and report on the auditee's compliance with applicable HUD laws and regulations regardless of the amount of Federal financial assistance. The auditor's report on compliance should include an opinion on the auditee's compliance with specific requirements

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applicable to each of its major programs. Reporting requirements are discussed further in Chapter 2. Major program means an individual assistance program or a group of programs in a category of Federal financial assistance which exceeds \$300,000 during the applicable year. A project which has an outstanding HUD-insured or guaranteed loan balance exceeding \$300,000 as of the reporting date shall be considered a major program. A mortgagee or loan correspondent which originates and/or services an aggregate of FHA-insured loans exceeding \$300,000 during the period under audit is considered a major program. In addition, a Government National Mortgage Association (Ginnie Mae) Issuer with a remaining principal balance exceeding \$300,000 as of the reporting date is considered a major program.

For Projects/Lenders/Issuers with HUD-assisted activity of \$300,000 or less for the period under audit (a non-major program), the auditor must also test and report on the entity's compliance with specific requirements. The auditor's report on compliance is described in Chapter 2.

Government Auditing Standards require the reporting of all material instances of noncompliance and an identification of total amounts questioned for each program, as a result of noncompliance. In addition, one program requires the reporting of all instances of noncompliance (see paragraph 1-6). Instances of noncompliance should be assigned a monetary value, if applicable.

- 1-4 Audit Authorization. Authority for audits covered by this audit guide and their respective due dates are as follows:

<u>Auditees</u>	<u>Audit Authorization</u>	<u>Due Date</u>
Multifamily Housing Mortgagors with Insured, Coinsured or Section 236 Subsidized Loans	Regulatory Agreement 24 CFR Part 251.706	Within 60 days after the end of the fiscal year

<u>Auditees</u>	<u>Audit Authorization</u>	<u>Due Date</u>
Insured Development Cost Certificate	24 CFR Part 207.27	Prior to final endorse- ment
Section 8 Assis- tance Payments: New Construction Substantial Rehabilitation	24 CFR Part 880.601 24 CFR Part 881.601	Within 60 days after the end of the fiscal year
Title II Nonsupervised Mortgagees Loan Correspondents Coinsuring Mortgagees	24 CFR Part 202.14 24 CFR Part 202.15 24 CFR Part 203.5	Within 90 days after the end of the fiscal year

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Title I Nonsupervised Lenders	24 CFR Part 202.5	Within 90 days after
Title I Loan Correspondents	24 CFR Part 202.6	the end of the fiscal year
Ginnie Mae	GNMA Handbook 5500.1 REV 6	Within 90 days after the end of the fiscal year
	GNMA Handbook 5500.2	Within 90 days after the end of the fiscal year

- 1-5 Matters Requiring Immediate Action. The auditor should specifically assess the risk of material misstatement of the financial statements due to fraud and should consider that assessment in designing the audit procedures to be performed. In making this assessment, the auditor should consider fraud risk factors contained in AICPA SAS No. 82, Consideration of Fraud in a Financial Statement Audit.

Normally, an audit in accordance with generally accepted auditing standards does not include audit procedures specifically designed to detect illegal acts. However, procedures applied for the purpose of forming an opinion on the financial statements may bring possible illegal acts to the auditor's attention.

If the auditor becomes aware of illegal acts or fraud that have occurred or are likely to have occurred, the auditor should promptly prepare a separate written report and include all questioned costs. The auditor should submit this report in accordance with the requirements of the Government Auditing Standards (Sections 5.18 - 5.20) to the HUD District Inspector General for Audit (DIGA), as the designated oversight official. A current list of DIGAs is available on the Internet at [www.hud.gov/oig/oigindex.html](http://www.hud.gov/oig/oigindex.html) and in the Appendix.

- 1-6 Planning the Audit. A letter of engagement between the auditee and the IA shall be prepared. The letter should state that the audit is to be performed in accordance with generally accepted auditing standards, the Government Auditing Standards, and this audit guide. It should specify that the scope of the audit and the contents of the financial report meet the requirements of this audit guide. It should also specify that the auditor is required to provide the Secretary of Housing and Urban Development, the HUD Inspector General and the GAO or their representatives access to working papers or other documents to review the audit. Access to working papers by HUD and GAO representatives includes making necessary photocopies.

Generally, the auditor should use professional judgement to determine the extent of testing necessary to support his/her opinion on the auditee's financial statements and to report on the auditee's compliance with applicable laws and regulations. Each of the applicable compliance requirements contained in this guide must be tested regardless of the amount of Federal financial assistance. Where the auditor decides not to perform detailed testing of a particular compliance requirement, the reasons therefore must be appropriately explained and documented in the working papers.

All material instances of noncompliance identified by the auditor must be reported as a finding, even in those cases where corrective action was taken by the auditee after the audit period. In addition, one program (see Chapter 7) requires the auditor to report all instances of noncompliance as findings regardless of materiality. For guidance, consult the particular program chapter. The schedule of findings and questioned costs (Chapter 2, Example F) must include the following information for each finding, where applicable, as required by the Government Auditing Standards: (a) the number of items and dollar value of the population; (b) the number of items and the dollar value of the selected sample; and (c) the number of items and the dollar value of the instances of noncompliance.

The auditor is required to obtain written representation from management that includes matters concerning compliance with program laws and regulations that have a material effect on the financial statements and each HUD-assisted program.

The auditor shall retain working papers and reports for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by a HUD office or the GAO to extend the retention period. When auditors are aware that HUD or the auditee is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and report.

- 1-7 Consideration of Internal Controls and Compliance. Overall guidance for the consideration of internal controls, testing and reporting requirements for Federal financial assistance programs is provided in the Government Auditing Standards.

The Government Auditing Standards require that a sufficient understanding of internal controls be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed. In fulfilling the audit requirement relating to an understanding of internal controls and assessing the level of control risk, the auditor should follow, at a minimum, the guidance contained in AICPA SAS No. 55, Consideration of the Internal Control Structure in a Financial Statement Audit and SAS No. 78, Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55. In addition, when auditing HUD programs, the auditor should perform tests of controls to evaluate the effectiveness of the design and operation of internal controls in preventing or detecting material noncompliance with the requirements of the HUD-assisted programs. The auditor should perform these procedures regardless of whether the auditor assesses the internal control risk below the maximum. The steps performed and conclusions reached should be clearly evidenced in the auditor's working papers. The working papers should clearly demonstrate the auditor's understanding and assessment of control risk related to internal controls established for HUD-assisted activities. Tests may be omitted only in areas when internal controls are likely to be ineffective in preventing or detecting noncompliance, in which case a reportable condition or material weakness should be reported.

- 1-8 Quality Control Review for Audit Reports. The HUD Office of Inspector General (OIG) has implemented procedures for evaluating audits performed by non-Federal auditors. As part of this evaluation of completed audits, the supporting audit working papers shall be made available upon request by the OIG. To facilitate these requests, the transmittal letter should include the name, firm address, and telephone number of the audit partner on the engagement and the IA's Federal employer ID number, as directed by Chapter 2 of this guide.

Whenever an evaluation of an audit report or working papers discloses inadequacies, the IA may be asked to take corrective action. If the OIG determines that the audit report and working papers are substandard or contain major inadequacies, it will consider filing complaints with the

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cognizant State Board of Accountancy and initiating action to debar the practitioner from further participation in Federal programs.

- 1-9 Corrective Action Plan. To assist the Department in resolving instances of noncompliance and material weaknesses in internal controls identified by the auditor, the auditee is required to submit a corrective action plan with the auditor's report on HUD-assisted programs. In the corrective action plan, which should be on the auditee's letterhead, the auditee must describe the corrective action taken or planned in response to findings identified by the auditor. In addition, the auditee must comment on the status of corrective action taken on prior findings. The submission of the corrective action plan is considered a necessary part of the Project/Lender/Issuer's audit requirement and should be submitted to HUD together with the auditor's reports and audited financial statements. HUD-required audit reports submitted without a corrective action plan will be considered incomplete and returned to the auditee for completion. There should be as many copies of the corrective action plan as there are copies of the audit report. Additional guidance concerning the corrective action plan is contained in Chapter 2 of this guide.
- 1-10 Fair Housing and Non-Discrimination. The following references should be used for determining civil rights and fair housing compliance: HUD Handbook 8004.1, Consolidated Civil Rights Monitoring Requirements for Section 8; 24 CFR Part 1 (Title VI of the Civil Rights Act, Americans with Disabilities Act, and others) and Part 8 (Section 504 of the Rehabilitation Act)(both of which are applicable to all HUD-assisted housing); and 24 CFR Part 100, The Fair Housing Act (applicable to all housing in the nation). The Fair Housing Act prohibits discrimination based on race, color, religion, national origin, sex, familial status or disability in all aspects of the sale or rental of a dwelling (familial status refers to family composition, such as number and ages of children). The prohibitions extend to actions which have disparate impact because of any of the prohibited bases.



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## CHAPTER 2 - REPORTING REQUIREMENTS AND SAMPLE REPORTS

- 2-1 Government Auditing Standards require that the auditor issue the following reports based on the audit of the financial statements: a report on the financial statements, a report on compliance with applicable laws and regulations, and a report on internal controls. In addition, there are additional reports required to be issued in an audit conducted in accordance with this audit guide. The audit report should be issued to the auditee's governing body and/or top official, as appropriate. The report cover should clearly indicate the HUD-assisted activities and period(s) which were audited. The auditee should transmit copies of the audit report and its corrective action plan to the applicable HUD office according to the particular program requirements.

It is expected that the specific compliance requirements identified in this guide will cover those laws and regulations that, if not complied with, could have a direct and material effect on the financial statements. In such cases, the compliance reports (in Section C below) and illustrated in this guide are the only reports necessary for reporting on the auditee's compliance with laws and regulations. However, if the IA, as part of the audit of the financial statements, considered laws and regulations in addition to those noted in this guide, for which noncompliance could have a direct and material effect on the financial statements, the auditor should also issue the compliance report in accordance with Government Auditing Standards.

The following reports are required to be submitted by the auditee:

- A. The auditor's report on the financial statements and any required supplementary schedules, according to the particular HUD program requirements, together with the auditor's report on the supplementary schedules stating whether that supplementary information is fairly stated in all material respects in relation to the basic financial statements taken as a whole (Example A).
- B. The auditor's combined report on internal controls as they relate to both financial reporting and administering the HUD-assisted programs. It must identify any reportable conditions and material weaknesses noted (Example B).
- C. A report on compliance with applicable laws and regulations that may have a direct and material effect on each HUD-assisted program including:
  - an opinion on compliance with specific requirements applicable to major HUD-assisted programs (Example C)
  - a report on compliance with specific requirements applicable to nonmajor HUD-assisted programs (Example D)

When performing tests of compliance requirements contained in Chapter 3 or 4, the IA should report on Fair Housing and Non-Discrimination. Where the HUD-assisted activity is nonmajor, fair housing reporting should be included in the auditor's report on nonmajor HUD-assisted programs. Where the HUD-assisted activity is major, the auditor's report on specific requirements applicable to fair housing should be separate (Example E) from the auditor's opinion on compliance with specific requirements applicable to major programs.

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The report on compliance should also identify and include all material instances of noncompliance. Note that the Office of Lender Activities requires the reporting of all instances of noncompliance, for audits of applicable non-supervised mortgagees and loan correspondents, regardless of materiality.

The findings should include an identification of all material questioned costs, as a result of noncompliance. In addition, the findings should contain adequate information necessary to facilitate the audit resolution process, (i.e. size of the universe and corresponding dollar amount, size and dollar amount of the sample, and number and corresponding dollar amount of the instances of noncompliance (Example F). Nonmaterial instances of noncompliance should be communicated to the auditee in accordance with the Government Auditing Standards.

- D. In the auditor's comments on audit resolution matters, the auditor should determine if significant findings from previous HUD required annual audits, HUD-OIG audits, or HUD management reviews have been corrected and disclose those which remain uncorrected at the time of the review (Example G).
- E. Any report from the auditors on illegal acts or fraud that have occurred or are likely to have occurred, including all questioned costs found as a result of these acts that the auditors become aware of, should be covered in a separate written report in accordance with the provisions of the Government Auditing Standards. This report should be sent to the cognizant District Inspector General for Audit (see Appendix for list of District Inspectors General for Audit). Illegal acts are to be reported on without regard to whether the condition giving rise to the questioned costs has been corrected or whether the auditee does or does not agree with the finding and questioned costs.
- F. A corrective action plan developed by the auditee, wherein the auditee officials describe the corrective action taken or planned in response to the findings identified by the auditor. The plan should also include comments on the corrective action taken on prior findings resulting from IA or relevant HUD-OIG audits and HUD program reviews (Example H).

2-2 The auditor may issue the required reports (Examples A through G) separately or simultaneously to the auditee; however, all required elements must be submitted simultaneously to the Department. In addition, the following information is to be included by the auditor with the audit report in an accompanying transmittal letter:

- A. The name, office address and telephone number of the audit partner on the engagement.
- B. The IA's Federal employer ID number.

2-3 Auditor's Reports. The following are illustrations of auditors' reports on financial statements, on internal controls; on compliance with specific requirements and the auditee's corrective action plan that may be issued in an audit in accordance with this guide. These reports are not meant to be all-inclusive; auditors should exercise professional judgement in tailoring their reports to the circumstances of individual audits. Guidance on modifications to reports on financial statements is included in AICPA SAS No. 58, Reports on Audited Financial Statements. Guidance on modifications to the report on internal controls and on compliance is included in AICPA SAS No. 60, Communication of Internal Control Structure Related Matters Noted in an Audit and AICPA SAS No. 74, Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance, respectively.

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Examples:

- A. Report on Audited Financial Statements and Supplemental Information.
- B. Report on Internal Controls.
- C. Opinion on Compliance with Specific Requirements Applicable to Major HUD Programs.
- D. Report on Compliance with Specific Requirements Applicable to Nonmajor HUD Program Transactions.
- E. Report on Compliance with Specific Requirements Applicable to Fair Housing and Non-Discrimination.
- F. Schedule of Findings and Questioned Costs.
- G. Auditor's Comments on Audit Resolution Matters Relating to HUD Programs.
- H. Corrective Action Plan (An Auditee Responsibility).

## EXAMPLE A

## REPORT ON AUDITED FINANCIAL STATEMENTS AND SUPPLEMENTAL INFORMATION

Independent Auditor's Report

To the Partners  
ABC Entity  
Anytown, U.S.A.:

We have audited the accompanying balance sheet of [the Entity] as of June 30, 199X, and the related statements of income, and cash flows (and changes in partners' equity)(and analysis of net worth) for the year then ended. These financial statements are the responsibility of [the Entity's] management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of [the Entity] as of June 30, 199X, and the results of its operations and its cash flows and its (analysis of net worth/changes in partners' equity) for the year then ended in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supporting information included in the report (shown on pages XX to XY) are presented for the purposes of additional analysis and are not a required part of the basic financial statements of [the Entity]. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued a report dated [date of report] on our consideration of [the Entity's] internal controls and a report(s) dated [date of report(s)] on its compliance with laws and regulations.

CPA and Company  
Certified Public Accountants

Anytown, U.S.A.  
[Date]

## EXAMPLE B

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROLS (COMBINED REPORT  
APPLICABLE TO THE FINANCIAL STATEMENTS AND HUD-ASSISTED PROGRAMS--  
REPORTABLE CONDITIONS WERE NOTED--NO MATERIAL WEAKNESSES)

To the Partners  
ABC Partnership  
Anytown, U.S.A.:

We have audited the financial statements of [the Entity] as of and for the year ended June 30, 199X, and have issued our report thereon dated [date of report]. We have also audited [the Entity's] compliance with requirements applicable to HUD-assisted programs and have issued our reports thereon dated [date of report].

We conducted our audits in accordance with generally accepted auditing standards and Government Auditing Standards, issued by the Comptroller General of the United States and the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide"), issued by the U.S. Department of Housing and Urban Development, Office of the Inspector General. Those standards and the Guide require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and about whether [the Entity] complied with laws and regulations, noncompliance with which would be material to a HUD-assisted program.

In planning and performing our audits, we obtained an understanding of the design of relevant internal controls and determined whether they had been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements of [the Entity] and on its compliance with specific requirements applicable to its (major) HUD-assisted programs and to report on internal controls in accordance with the provisions of the Guide and not to provide any assurance on internal controls.

The management of the [the Entity] is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal controls. The objectives of internal controls are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles and that HUD-assisted programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal controls, errors, irregularities or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

We performed tests of controls, as required by the Guide, to evaluate the effectiveness of the design and operation of internal controls that we considered relevant to preventing or detecting material noncompliance with specific requirements applicable to [the Entity's] HUD-assisted programs. Our procedures were less in scope than would be necessary to render an opinion on internal control policy and procedures. Accordingly, we do not express such an opinion.

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We noted certain matters involving internal controls and their operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants.

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal controls that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements or to administer HUD-assisted programs in accordance with applicable laws and regulations.

[Include paragraphs to describe the reportable conditions noted.]

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited or that noncompliance with laws and regulations that would be material to a HUD-assisted program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal controls would not necessarily disclose all matters in internal controls that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

[We also noted other matters involving internal controls and their operations that we have reported to the management of [the Entity] in a separate communication dated September 8, 199X]

This report is intended for the information of the audit committee, management, and the Department of Housing and Urban Development. However, this report is a matter of public record and its distribution is not limited.

[Firm Signature]

[Date]

## EXAMPLE C

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS  
APPLICABLE TO MAJOR HUD PROGRAMS

To the Partners  
ABC Partnership  
Anytown, U.S.A.:

We have audited the financial statements of [the Entity] as of and for the year ended June 30, 199X and have issued our report thereon dated [date of report]. In addition, we have audited [the Entity's] compliance with the specific program requirements governing [list those requirements tested] that are applicable to each of its major HUD-assisted programs, for the year ended June 30, 199X. The management of [the Entity] is responsible for compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards, *Government Auditing Standards*, issued by the Comptroller General of the United States, and the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide") issued by the U.S. Department of Housing and Urban Development, Office of Inspector General. Those standards and the Guide require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about [the Entity's] compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, [the Entity] complied, in all material respects, with the requirements described above that are applicable to each of its major HUD-assisted programs for the year ended June 30, 199X.

This report is intended for the information of the audit committee, management, and the Department of Housing and Urban Development. However, this report is a matter of public record and its distribution is not limited.

[Signature]

[Date]

EXAMPLE D

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS  
APPLICABLE TO NONMAJOR HUD PROGRAM TRANSACTIONS

To the Partners  
ABC Partnership  
Anytown, U.S.A.:

We have audited the financial statements of [the Entity] as of and for the year ended June 30, 199X, and have issued our report thereon dated August 14, 199X.

In connection with our audit of the 199X financial statements of [the Entity] and with our consideration of [the Entity's] internal controls used to administer HUD programs, as required by the *Consolidated Audit Guide for Audits of HUD Programs* (the "Guide") issued by the U.S. Department of Housing and Urban Development, we selected certain transactions applicable to certain nonmajor HUD-assisted programs for the year ended June 30, 199X.

As required by the Guide, we performed auditing procedures to test compliance with the requirements governing [list those requirements tested] that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on [the Entity's] compliance with these requirements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under the Guide.

This report is intended for the information of the audit committee, management, and the Department of Housing and Urban Development. However, this report is a matter of public record and its distribution is not limited.

[Signature]

[Date]



EXAMPLE E

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH SPECIFIC REQUIREMENTS  
APPLICABLE TO FAIR HOUSING AND NON-DISCRIMINATION

To the Partners  
ABC Partnership  
Anytown, USA

We have audited the financial statements of [the Entity] as of and for the year ended June 30, 199X, and have issued our report thereon dated August 14, 199X.

We have applied procedures to test [the Entity's] compliance with Fair Housing and Non-Discrimination requirements applicable to its HUD-assisted programs, for the year ended June 30, 199X.

Our procedures were limited to the applicable compliance requirement described in the *Consolidated Audit Guide for Audits of HUD Programs* issued by the U.S. Department of Housing and Urban Development, Office of Inspector General. Our procedures were substantially less in scope than an audit, the objective of which would be the expression of an opinion on [the Entity's] compliance with the Fair Housing and Non-Discrimination requirements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under the Guide.

This report is intended for the information of the audit committee, management and the Department of Housing and Urban Development. However, this report is a matter of public record and its distribution is not limited.

[Signature]

[Date]

## EXAMPLE F

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
 (Should be Attached to Auditor's Report on Compliance)

When the auditor identifies a finding, this schedule must include the following information for each finding, where applicable: (a) the size and corresponding dollar value of the population, (b) the size and dollar value of the sample tested, and (c) the size and dollar value of the instances of noncompliance.

The Government Auditing Standards state that well-developed findings generally consist of the following attributes:

- **Statement of condition** - the nature of the deficiencies, e.g., a regulation not being followed, a control procedure not followed or one which is inadequate.
- **Criteria** - what the auditee should be doing, e.g. the specific regulation, a prudent management practice, or an internal control procedure.
- **Effect** - what happened as a result of the condition; this should be monetized in all possible instances and described as thoroughly as possible.
- **Cause** - why the condition exists, e.g. the auditee was unaware of the regulation or internal control was not a high priority of the auditee.
- **Recommendation** - what the auditee should do to correct the condition, normally addresses the cause e.g. develop procedures to implement regulation or follow established procedures.

The auditor should attempt to identify the condition, criteria, effect, and cause to provide sufficient information to HUD officials to permit timely and proper corrective action. These findings may also serve as a basis for HUD to conduct additional work. In addition, as part of the finding, the auditor is required to make a recommendation for corrective action to the auditee. As part of this report, the auditor is required to include the auditee's summary comments on the findings and recommendations in the report. In addition, the auditee is responsible for developing a separate corrective action plan (see Example H) based on the auditor's findings and recommendations and including the plan when submitting the auditor's report. If corrective action is not necessary, a statement by the auditor describing the reason it is not should accompany the audit report.

## EXAMPLE G

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AUDITOR'S COMMENTS ON AUDIT RESOLUTION MATTERS RELATING TO THE HUD  
PROGRAMS\*

The Project has not taken corrective action on findings from prior audit report, \* number and title:

Finding No. 1        -        The required documentation with regard to eligibility was not obtained for tenants receiving rent supplements.

Status                -        The Project has not obtained the required documentation from third-party sources nor has the Project reimbursed the appropriate programs. The amount of the rent supplements received for these tenants for the prior audit period was \$15,350.

Finding No. 2 -

Status                -

\* --        This includes all prior audits, program review reports and state agency reports.

\* --        The auditor may rely on management's representation as to the completeness of reports submitted during the audit period. The auditor does not have to independently confirm the completeness of audit and other reports received by the auditee.

## EXAMPLE H

## CORRECTIVE ACTION PLAN

Name and Number of Project \_\_\_\_\_  
 Auditor/Audit Firm \_\_\_\_\_  
 Audit Period \_\_\_\_\_

The following is a recommended format to be followed by auditees for submitting a corrective action plan:

Section I - Internal Controls ReviewA. Comments on Findings and Recommendations

The auditee should provide a statement of concurrence or nonconcurrence with the findings and recommendations. If the auditee does not agree with a finding, specific information should be provided by the auditee to support its position. If the information is voluminous, an appendix may be attached to the submission.

B. Actions Taken or Planned

The auditee should detail actions taken or planned to correct deficiencies identified in the report. Appropriate documentation should be submitted for actions taken. For planned actions, auditees should provide projected dates for completion of major tasks. Officials responsible for completing the proposed actions should also be identified. If the auditee believes a corrective action is not required, a statement describing the reasons should be included.

C. Status of Corrective Actions on Prior Findings

The auditee must comment on all prior findings whether or not corrective action has been completed. The auditee should provide a report on the status of corrective actions taken on prior findings that remain open. An update should be included on dates for completion of major tasks and responsible officials for any actions not completed. In addition, documentation should be submitted for any actions the auditee considers completed.

Section II - Compliance ReviewA. Comments on Findings and Recommendations

(See Section I. A. above.)

B. Actions Taken or Planned

(See Section I. B.)

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C. Status of Corrective Actions on Prior Findings

(See Section I. C.)

Financial Statements and Supplemental Information Required for:

Type of Statement	Section 8	Insured & Multifamily	Ginnie Mae Issuers	Certificate of Actual Cost	Title II Mortgagees	Title I Lenders
Balance Sheet	X	X	X	X	X	X
Statement of Operations and Retained Earnings or Statement of Profit and Loss	X	HUD 92410	X	X	X	X
Statement of Change in Partner's Equity		X				
FASB 95 Cash Flow <sup>1</sup>	X	X	X		X	X
Notes to F/S	X	X	X	X	X	X
Supplemental Data <sup>2</sup>		X				
Statement of Receipts and Disbursements		X				
Issuers Adjusted Net Worth			X		X	X
Parent's Adjusted Net Worth (if appropriate)			X			
Certificate of Actual Cost				X		
Insurance Requirement			X			

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<sup>1</sup>The Statement of Receipts and Disbursements may be omitted if the Statement of Cash Flows is prepared using the Direct Method

<sup>2</sup>See HUD Handbook 4370.2 Rev-1

## CHAPTER 6 - GINNIE MAE ISSUERS OF MORTGAGE-BACKED SECURITIES AUDIT GUIDANCE

- 6-1 Program Objective. The Government National Mortgage Association, also known as Ginnie Mae, is a wholly-owned Government corporation. Created by Congress in 1968, Ginnie Mae's mission is to support expanded, affordable housing in America by providing an efficient government-guaranteed secondary market vehicle linking the global capital markets with the federal housing market. It does this by facilitating secondary market activities for packaged residential mortgages. Through its well known mortgage-backed securities (MBS) and multiclass programs, Ginnie Mae creates a vehicle for channeling funds from the securities markets into the mortgage market and helps to increase the supply of credit available for housing.
- 6-2 Program Procedures. The parties involved in the MBS program are Ginnie Mae, the securities issuer, the securities dealer, the investor, a custodian of mortgage documents, a mortgage servicer (often the issuer) and perhaps a transfer agent. Once approved by Ginnie Mae, the issuer of the mortgage-backed securities is responsible for acquiring eligible mortgages, creating a pool of mortgages to be held by a custodian, issuing the securities backed by a pool of mortgages, arranging for the marketing of the securities, servicing the mortgages in the pool, administering the securities outstanding and making the full and timely payment of all amounts due to the investors. The issuer is responsible for using its own resources to cover shortfalls in amounts due to investors that result from mortgage delinquencies or foreclosures.

For each pool or loan package of mortgages and accompanying issue of securities, there can be only one issuer. While the issuer is responsible for servicing the pool or loan package of mortgages, the servicing may be carried out on behalf of the issuer, by another servicer (referred to as a subcontract servicer), which must also be a Ginnie Mae-approved issuer. The issuer is responsible for and fully liable for the satisfactory performance of any work performed by a subcontract servicer. All activities of any subcontract servicer must be covered by a contractual agreement between the issuer and the subcontract servicer, and approved by Ginnie Mae.

The issuer may not delegate or transfer to others its obligations to: (a) make monthly payments to investors; (b) submit required monthly reports to Ginnie Mae; (c) make the payment of the guarantee fee to Ginnie Mae; (d) withdraw mortgage documents from the document custodian; and (e) maintain the Register of Certificate Holders (HUD Handbooks 5500.1 and 5500.2).

- 6-3 Reference Material. Ginnie Mae program regulations are contained in 24 CFR Part 300 through 395. HUD Handbooks for Ginnie Mae are as follows:

<u>HUD Handbook No.</u>	<u>Title</u>
5500.1, Rev. 6	Government National Mortgage Association Mortgage-Backed Securities Guide for the Ginnie Mae I Program
5500.2	Government National Mortgage Association Mortgage-Backed Securities Guide for the Ginnie Mae II Program

The issuer should have a copy of the appropriate guide(s). Information on the most recent issuances of the guides may be obtained from Ginnie Mae at (202) 401-8794. Current guides are also available on the Internet at [www.ginniemae.gov](http://www.ginniemae.gov).

- 6-4 **Reporting Requirements.** Ginnie Mae issuers of MBS, including those Ginnie Mae-approved issuers who are inactive, are required to submit the following financial statements, reports and supplemental information on an annual basis:

<u>Type of Report</u>	<u>Reference in IG 2000.4 REV-1</u>
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Financial Statements and Opinion	Chapter 2, Section 2-1
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Internal Controls	Chapter 2, Section 2-1
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Compliance with Specific Requirements	Chapter 2, Section 2-1
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Supplemental Information:

Issuer's Adjusted Net Worth	Chapter 6, Section 6-5
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Parent's Adjusted Net Worth (if appropriate)	Chapter 6, Section 6-4
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Insurance Requirement	Chapter 6, Section 6-5
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Corrective Action Plan (if appropriate)	Chapter 1, Section 1-9
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- A. **Audited Financial Statements.** Issuers are required to submit audited annual financial statements which include a balance sheet, statement of operations, cash flow statement, notes to the financial statements, and supplemental schedules as stipulated in Chapter 2 of this guide. The financial documents are to be submitted to Ginnie Mae's Review Agent using the Transmittal/Checklist presented in Attachment F.
- B. **Other Reports.** In addition to the financial statements, all issuers must submit a report on internal controls, and a report on compliance with specific requirements. A sample report on consideration of internal controls and report of compliance with specific requirements are included in Chapter 2.

The computation of the issuer's and issuer's parent adjusted net worth and computation of issuer's insurance requirements are to be reported on supplemental schedules to the basis financial statements. The computation of the issuer's and issuer's parent adjusted net worth is designed to eliminate those assets considered unacceptable by Ginnie Mae. Note that the adjusted net worth computation for the issuer's parent is only required when the issuer's parent presents a consolidated financial statement along with consolidating schedules that reflect the financial condition of the issuer and the issuer makes up less

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than 40 percent of the parent's equity. The required format for presenting this analysis is provided in Attachment B for the issuer and Attachment C for the issuer's parent. The required format for presenting the analysis of the issuer's insurance is presented in Attachment D.

Ginnie Mae requires submission of audited financial statements exclusively of the issuer. However, Ginnie Mae will accept alternative financial statements (i.e., not exclusively of the issuer) if certain conditions are met as stated below:

1. For issuers that make up 40 percent or more of the equity of its parent, Ginnie Mae will accept consolidated financial statements of the issuer's parent provided: the consolidating schedules, which distinguish the balance sheet and operating statement of the Ginnie Mae issuer are included with the parent's audit. The consolidating schedules must be subjected to the auditing procedures applied to the consolidated statement of the parent.
2. For an issuer whose equity is less than 40 percent of the equity of its parent, Ginnie Mae will accept consolidated financial statements of the issuer's parent provided the conditions in item (1) above are met and the issuer's parent enters into a Corporate Guarantee Agreement (Agreement) with Ginnie Mae to guarantee the performance of the issuer. The parent must meet the terms and conditions of the Agreement for the issuer to remain in good standing with Ginnie Mae.

Furthermore, the issuer is required to submit with its parent's consolidated audited financial statements, an adjusted net worth calculation on the parent. The parent's net worth, after adjustments for unacceptable assets, is required to be at least 110 percent (120 percent for issuers approved to issue manufactured housing or multifamily pools) of the required net worth of the Issuer. The parent's audited financial statement and adjusted net worth calculations must be audited by the parent's auditor in accordance with this Audit Guide. The parent must also demonstrate in its adjusted net worth calculation that it meets the above 110 percent (120 percent for issuer approved to issue manufactured housing or multifamily pools) requirement.

The required format for presenting the "Presentation of Adjusted Net Worth Calculation for Issuer's Parent" is provided in Attachment C of this Chapter.

3. For issuers that are federally or state-regulated institutions, such as those under the supervision of Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, Ginnie Mae will accept audited financial statements on the issuer's parent, as long as the issuer makes up 90 percent or more of the parent's equity and there is no more than one bank holding company covered in the audit.

In addition to the audited financial statement of the issuer's parent, the issuer must submit its unaudited regulatory report (Call report, OTS Report or 10K).

Although Ginnie Mae may accept alternative audited financial statements, all other required reports (internal controls, compliance with specific requirements,



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adjusted net worth calculation, insurance requirement) must be prepared by the IA exclusively for the issuer.

A sample auditor's report on the consolidating balance sheet and operating statement is included as Attachment E to this Chapter.

- C. Submission of Reports. Two copies of the audited financial statements and auditor's reports should be submitted by the issuer, independent of whether the issuer had securities or commitment authority outstanding. Reports must be submitted within 90 days of the end of the issuer's fiscal year to Ginnie Mae's Review Agent. The Review Agent's address may be obtained from the address list "Addresses" found in HUD Handbooks 5500.1 and/or 5500.2.

D. Single Auditor Approach

In many instances it may be to the advantage of the custodian, the issuer, or both to engage an IA to conduct a review of the mortgage documents held by a particular custodian for several issuers rather than to have each issuer require that a different IA review that part of the custodial documents pertaining to each issuer's pools. The single auditor approach also may solve practical problems associated with travel when the issuer, custodian, and IAs are not located near each other, thus reducing the cost of compliance while assuring necessary audit coverage.

To determine if the single auditor approach is practical in a given situation, the IA and issuer should contact the custodian(s) holding the issuer's pool loan documents to determine the extent of the custodian's activities with other issuers. Arrangements then may be reached as to the most effective approach to conducting the review of custodial documents. Under the single auditor approach, the custodian will arrange with an IA to review documents relating to each of the respective issuer's pools. Separate reports then will be prepared by the IA for each issuer's pools.

The single auditor approach or the review of custodial documents by the issuer's IA are both acceptable methods in completing the Custodial Review section of the audit guide.

## 6-5 Compliance Requirements and Suggested Audit Procedures

A. Federal Financial Reports.

1. Compliance Requirement. Issuers participating in HUD-assisted activities are required to ensure that financial status reports contain reliable financial data and are presented in accordance with the terms of applicable agreements between the entity and HUD. The individual agreements contain the specific reporting requirements that the entity is to follow.
2. Suggested Audit Procedures
  - a. Identify all required financial reports by inquiry of the issuer.
  - b. Obtain an understanding of the auditee's procedures for preparing and reviewing the financial reports.

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- c. Select a sample of financial reports, other than those which are included in the audited financial statements, and determine that the reports selected are prepared in accordance with HUD instructions.
  - d. For the sample, trace significant data to supporting documentation, i.e. worksheets, ledgers, etc. Report all material differences between financial reports and issuer records.
  - e. Review significant adjustments made to the general ledger accounts affecting HUD-assisted activity and evaluate for propriety.

B. Eligibility to Issue Mortgage-Backed Securities

- 1. Compliance Requirement. To be approved and maintain eligibility to issue Ginnie Mae-guaranteed mortgage backed securities and act as administrator of such securities, an applicant must meet and maintain the following requirements:
  - a. Be an FHA-approved mortgagee in good standing. A State or local government instrumentality that is an FHA-approved mortgagee is eligible. Mortgagees approved by FHA only as loan correspondents are not eligible to be Ginnie Mae issuers.
  - b. For issuers approved by Fannie Mae or Freddie Mac, a loss of either approval may cause the issuer to become ineligible to issue and service Ginnie Mae mortgage-backed securities.
  - c. Have as a principal element of its business operation the origination or servicing of mortgage loans.
  - d. Conduct its business operations in accordance with accepted sound mortgage lending and servicing practices, ethics, and standards, and have the experience, management capability, and access to adequate facilities necessary to assure Ginnie Mae of its ability to issue and service mortgage-backed securities. Except in instances where the issuer can demonstrate that an alternative arrangement constitutes a sound business practice, the issuer must have at least three full-time officers and one additional employee, each with sufficient experience in the origination and/or servicing of mortgages of the type to be pooled to assure an ability to manage the pool on a long-term basis; the officer in charge of day-to-day operations must be a full-time employee solely of the issuer firm; and the issuer's offices must be self-contained and separate from those of any other entity.
  - e. Maintain policies that prohibit any discrimination of a borrower based on race, religion, color, sex, national origin, age, familial status or disability. The issuer shall comply with any applicable rules, regulations, and orders of general applicability issued under Title VI of the Civil Rights Act of 1964; Executive Order 11063, Equal Opportunity in Housing, issued November 20, 1962; Title VII of the Civil Rights Act of 1968, as amended; and with applicable rules and regulations of the Federal Housing Administration. Moreover, this section incorporates by

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reference section 202 of Executive Order 11246, Equal Employment Opportunity, issued on September 24, 1965, as amended. The issuer is required to comply with the implementing rules and regulations of the Department of Labor (41 CFR Part 60-1) and the Department of Housing and Urban Development (24 CFR Part 130).

- f. Have and maintain fidelity bond coverage and a mortgage servicing errors and omissions policy based on the issuer's total servicing portfolio in accordance with HUD Handbooks 5500.1, Chapter 2 and 5500.2, Chapter 3, which names Ginnie Mae as loss payee.
- g. Maintain a net worth based on an audited financial statement prepared in accordance with generally accepted accounting principles in assets acceptable to Ginnie Mae, as outlined in Section G. 2. of this Chapter.

## 2. Suggested Audit Procedures

- a. Determine that the issuer meets requirements covered in Section 6-5, paragraph B. above.
- b. Test whether the issuer has and follows an established policy which prohibits discrimination in housing and lending as provided by HUD Handbooks 5500.1, Chapter 2, 5500.2, Chapter 3 and Section 1-10 of this guide.
- c. Recompute the issuer's required fidelity bond and mortgage servicing errors and omissions coverage policy at the end of the fiscal year in accordance with Handbooks 5500.1, Chapters 2 and 6, and 5500.2, Chapter 3. Verify that Ginnie Mae is named as the loss payee. Also inquire that the required levels of insurance were maintained throughout the year, with testing of the adequacy of insurance at least on a quarterly basis. Also verify that the fidelity bond and errors and omissions policies are written by an insurance carrier which has a Best's rating of B+ or better, and is specifically licensed or authorized by law to transact business with the state or territory where the name insured has its corporate headquarters. Lloyd's of London, although not rated, is an acceptable insurer.

An issuer's minimum insurance coverage must comply with the following, based on the issuer's total servicing portfolio irrespective of ownership:

- (1) For issuers with a total mortgage servicing portfolio of \$100 million or less: \$300,000.
- (2) For issuers with a total mortgage servicing portfolio of more than \$100 million and up to \$500 million: \$300,000, plus 0.15 percent of the amount of total servicing in excess of \$100 million.

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- (3) For issuers with a total mortgage servicing portfolio of more than \$500 million and up to \$1 billion: \$900,000, plus 0.125 percent of the amount of total servicing in excess of \$500 million.
  - (4) For issuers with a total mortgage servicing portfolio of more than \$1 billion: \$1,525,000, plus 0.1 percent of total servicing in excess of \$1 billion.

The maximum mortgage servicing errors and omission insurance coverage requirement is \$20,000,000. The maximum fidelity bond coverage is not limited.

The required format for presenting the “Presentation of Insurance Requirement” is provided in Attachment D of this Chapter.

- d. Determine whether the issuer is an affiliate (parent, subsidiary, or related party) of any other Ginnie Mae issuer(s). All affiliated Ginnie Mae issuers should be identified in the auditor’s verification of insurance. If an affiliate(s) is covered by the same insurance policy, then the servicing of each issuer must be added to calculate the combined total servicing portfolio. The amount of this combined servicing portfolio should be used to determine the minimum required insurance coverage.
- e. Compare the issuer’s adjusted net worth (net worth reported in the audited financial statements as adjusted for any Ginnie Mae unacceptable assets) to the minimum required net worth as discussed in Section 6-5, paragraph G.2 of this Chapter.

#### C. Review of Custodial Documents

- 1. Compliance Requirements. Documents relating to the pooled mortgages are required to be held on Ginnie Mae’s behalf for the life of the pool by a custodial institution. It is the issuer’s responsibility to arrange for such an institution to hold the documents. The custodial relationship must be evidenced by the execution of a “Master Custodial Agreement” with the custodian certifying on the reverse side of the Schedule of Pooled Mortgages that it has examined and has in its possession the required documents.

A custodial institution is permitted to function as custodian to more than one issuer. An issuer may use more than one custodian. Pools issued on or after February 1, 1979 must have a single custodian, unless Ginnie Mae has given written permission for more than one custodian.

A custodial institution must meet the eligibility requirements as specified in Chapter 3 of the Ginnie Mae Guide, Standards for Document Custodians, hereinafter referred to as Document Custodial Manual (HUD Handbook 5500.1, Appendix 77 and HUD Handbook 5500.2, Appendix 53).

The review of the document custodian must be performed at the document custodian facility. If the issuer’s securities outstanding is less than \$25 million

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and there has been no increase in the number of pools held by the document custodian within the last fiscal year, Ginnie Mae will permit an off-site review of the document custodian. The Auditor must follow the procedures in Section 6-5, paragraph C.2. below. All document custodians must have an on-site review every three years.

2. Suggested Audit Procedures

- a. Determine if the issuer uses more than one custodial institution. If more than one custodian is used, at least one custodial institution must be reviewed each year and all custodial institutions must be reviewed within a three year cycle. Determine that the custodial institution meets the following eligibility requirements.
  - (1) Is a federally regulated financial institution in good standing with its primary regulator, and not in receivership, conservatorship, liquidation or any other management oversight by its primary regulator, unless operating under an approved management plan.
  - (2) Maintains a secure, 1 and 1/2 hours fire resistant storage facility with adequate access controls.
  - (3) Utilizes knowledgeable employees in its custodial function to handle mortgage documents and perform custodial functions.
  - (4) Maintains for review annual financial statements audited by an independent auditor for itself or its parent.
  - (5) Maintains the minimum insurance requirements of its primary regulator and maintains coverage to indemnify against losses involving Ginnie Mae pools and loan documents custody.
  - (6) Maintains updated written procedures within its operation, in addition to the Document Custodian Manual.
  - (7) Satisfies eligibility requirements and other requirements as directed by Ginnie Mae.
  - (8) Self custodial issuers must maintain a separate trust department which is physically separate from the servicing area and operations. It must also have obtained prior approval to exercise fiduciary powers from its primary regulator. Such fiduciary powers must include ordinary trust services such as personal trust services, personal representative services (executor), guardianship, custodian services and/or investment advisory services offered to the public and not be limited to maintaining custody of valuable documents for Ginnie Mae issuers. The trust service function must be subject to periodic review or inspections by its primary regulator.

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- (9) If custody is by an affiliate, the custodial institutions must either meet all the requirements in paragraph C.2.a.(8) above, or if the custodial documents are not held in the trust department, the custodian must provide evidence that there is a vertical independence between the issuer and the custodial/warehouse institution.
- b. Verify that the custodial institution maintains or performs the following inventory accounting requirements:
- (1) Maintains an Issuer Master File which contains the Issuer Custodial Register, any blanket legal opinions, copy of the issuer's corporate resolution for a name change, and any other applicable issuer level documents.
  - (2) Maintains an Issuer Custodial Register which includes a list of pools currently in custody (must provide pool identification numbers), the actual and/or due dates for final certification and recertification, and a count of the total number of pools in custody.
  - (3) Maintains a Pool Master File for each pool in custody which contains a copy of the Master Custodial Agreement, Schedule of Pooled Mortgages, form HUD 11711B (Certification and Agreement), form HUD 11711A (Release of Security Interest) if applicable, original blanket interim assignment(s) (a copy of which is included in each individual loan file to which the blanket interim assignment applies), copies of opinion(s) from qualified outside legal counsel (originals maintained in the issuer master file), original pool level waiver letters from Ginnie Mae, and all forms HUD 11708 (Request for Release of Documents) for liquidated release codes.
  - (4) Has performed an Annual Physical Inventory of all pools held for the issuer, which will include at a minimum a reconciliation of the pool numbers on the issuer custodial register to a current issuer provided listing of pools, and the pool numbers on the issuer custodial register agree to the pool master files in custody.
  - (5) Maintains a Nonliquidation Release Inventory/File of all forms HUD 11708 submitted on or after July 1, 1992 on the basis of the nonliquidation reason code. If a file is maintained, copies of the forms HUD 11708 must be kept in chronological order by document release date. If an inventory is maintained it must contain the pool number, FHA/VA/Rural Housing Service of the Department of Agriculture (RHS) case number or loan number, and the document release date.

If any documents have been released for more than 180 days, the custodian is required to notify the issuer of the overdue

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documents every 90 days. The notification must be in writing and documented in the inventory or file.

- c. If more than one custodial institution is used, it will be necessary for the issuer to identify which pools are at which custodial institution in order to select a sample of pooled mortgages for that institution. If the issuer uses only one custodial institution, obtain a list of the pools. Select a representative sample of Ginnie Mae pools for review. For pools selected determine if the pools include:

- (1) An original form HUD 11711A (Release of Security Interest) executed by any and all secured institution(s) relating to any or all mortgages included in the mortgage pool that are being reviewed and that were closed after March 31, 1979. The form should state:

“The lending or other financing institution named herein agrees to relinquish any and all right, title or interest it may have in mortgages to be placed in this Ginnie Mae mortgage-backed securities pool no later than the date and time of delivery (release) of the securities by Ginnie Mae and/or its agent.”

and/or

- (2) An executed original form HUD 11711B (Certification) signed by an officer of the issuer covering the mortgages that are being reviewed and that were closed after March 31, 1979, stating that:
- (a) Release(s) of security interest (form HUD 11711A) delivered by the issuer to the custodian comprise(s) all evidence of any security agreements affecting any and all mortgages in this pool; or
- (b) Other than the unrecorded assignment to Ginnie Mae, there are and will be no other security agreements affecting any mortgages in this pool.

Note: If there has been a transfer of issuer responsibility and the pool was issued more than three years ago, the forms HUD 11711A and/or 11711B are not required to be in the custodial file.

- d. Obtain a copy of the original Schedule of Pooled Mortgages (form HUD 11706)<sup>1</sup> from the document custodian for each of the pools selected. The purpose of the Schedule of Pooled Mortgages is to provide a means of

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<sup>1</sup> For programs other than the Single Family Mortgage-Backed Securities Program, the form number, prior to January 1, 1996, was:

- Project loans: form HUD 11721.
- Manufactured home loans: form HUD 11725.

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identifying and controlling mortgages placed in the pool which secure the obligations issued. Accordingly, select a sample of pooled mortgages from the Schedule of Pooled Mortgages.

- e. For sampled mortgages, review the custodial files for the following documents and compare the information shown on these documents to the information on the Schedule of Pooled Mortgages. Procedures for the custodian document review are contained in Paragraph 8-4 and Appendix 77 of Ginnie Mae Handbook 5500.1 and Paragraph 7-5 and Appendix 53 of Ginnie Mae Handbook 5500.2. Reconcile and report on any differences.
  - (1) The original note or other evidence of indebtedness endorsed in blank and without recourse.
  - (2) An assignment to Ginnie Mae of the mortgage or other security instrument in recordable form but not recorded. The assignments to Ginnie Mae can be in blanket form. The blanket assignments must apply to mortgages in the same pool and same recording jurisdiction. If the pool was issued after March 31, 1979, and if the mortgage was originated by a mortgagee other than the issuer, there also must be a recorded assignment, if state law requires recordation in order to make the assignment valid against all lien holders from the originating mortgagee to any intervening interest holder and from such holder to any further holders of mortgage ownership. An assignment to the issuer must immediately precede the unrecorded assignment to Ginnie Mae. These interim assignments must be either originals or certified copies of the originals and, if required by state law to assure validity, be either recorded or certified by the issuer to have been transmitted for recordation.
- f. Determine that within 12 months of the issuance of the securities, transfer of issuer and/or custodial responsibility that the document files contain the following documents. Report any missing documentation as a finding.

Within 12 months of issuance of the securities the following documents must be in the custodial file.

- (1) Original evidence of insurance or guaranty signed by FHA, VA or RHS. If the loan is a VA vendee loan or contract, there will not be evidence of guaranty. If evidence of insurance or guaranty is not on file, determine from the issuer why the required documents are missing. Loans that cannot be insured or guaranteed must be withdrawn from the pool but only after obtaining Ginnie Mae's approval.
  - (2) Original recorded mortgages (or other security instruments) signed by the mortgagor securing repayment of the indebtedness. (NOTE: Compare the mortgagor's name as it appears on the
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Schedule of Pooled Mortgages with that which appears on the recorded mortgage to assure identity). Copies of the recorded mortgage are acceptable if the copies clearly show the document recording information.

- (3) Evidence that a mortgagee title insurance policy has been obtained or other evidence of the title's acceptability to FHA, VA or RHS (not required in cases involving conveyance of HUD Secretary-owned property, if an exception has been authorized by Ginnie Mae, or VA vendee loans or contracts). Copies of mortgagee title insurance policies are acceptable.
- (4) A complete chain of original recorded interim assignments. These are not required if the mortgage is retained by the original lender. Copies of the recorded interim assignments are acceptable if the copies clearly show the document recording information.
- (5) Verify that the custodian has completed the final certification on the back of the Schedule of Pooled Mortgages.

Within 12 months of a transfer of issuer responsibility the following documents must be in the custodial file and the custodian is required to have completed recertification of the appropriate pools:

- (6) An updated endorsement on the promissory notes;
- (7) A recorded assignment of the mortgage to the issuer, and
- (8) All documents required in paragraphs C.2.d and C.2.e above are in the custodial files.

Within 12 months of a transfer of custodial responsibility all documents required in C.2.d and C.2.e above must be in the custodial file. The custodian is required to have completed recertification of the appropriate pools within 12 months.

Report any pool(s) for which the final certification or recertification is past due and has not been completed.

- g. Determine that documents and/or loan files released from custodial files are evidenced by a Request for Release of Documents (form HUD 11708). For the sampled mortgages:

- (1) Ascertain whether the custodian is in possession of a form HUD 11708 for documents and/or files removed from the custodian's care.
  - (2) Prepare a list of missing documents and/or loan files not supported by a form HUD 11708. This listing should be
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reviewed with the custodian and subsequently with the issuer.  
Any items not reconciled should be reported as a finding.

- h. Select paid-in-full and/or foreclosed mortgages listed on form HUD 11708 on a test basis. Verify that these mortgage documents are no longer with the custodian. The custodian should note this removal on its inventory control record (The Schedule of Pooled Mortgages).

Any discrepancies should be noted on an exceptions listing noting the Pool Number, Mortgagor, and the defect, and reported as a finding. This listing should be reviewed with the custodian and errors corrected by the custodian. The custodian should furnish this listing to the appropriate issuers and the IA should subsequently review with the issuer the reasons for any missing or deficient documents. Missing documents for mortgages which are still current by the issuer's records could be an indication that the issuer has received mortgage pay-offs and not passed through payments to securities holders.

- i. In lieu of an on site audit of the document custodian, the following procedures are acceptable, provided the conditions set forth in section C.1. above have been met.
- (1) Confirm that the document custodian meets all the eligibility requirements as stated in Section 6-5, paragraph C.2.a. above. A written certification from the document custodian that it meets all eligibility requirements is acceptable.
  - (2) Confirm that the document custodian maintains or performs the required inventory accounting required in Section 6-5, paragraph C.2.b. above. A certification from the document custodian that it (i) maintains the Issuer Master File for the issuer, (ii) maintains a Pool Master File for each pool in custody for the issuer, (iii) has performed and provided the date of the Annual Physical Inventory for all pools held for the issuer, (iv) maintains a Non-Liquidation Release Inventory/File of all forms HUD 11708 submitted on or after July 1, 1992 on the basis of the non-liquidation reason code, and (v) obtains from the document custodian a copy or list of any documents that have been released for more than 180 days and have not been returned to the document custodian. Item (v) above should be reviewed with the issuer and any items not reconciled should be reported as a finding.
  - (3) Select a representative sample of Ginnie Mae pools for review and request verification from the document custodian of the following:

- (a) Using the issuer's trial balance, the custodian must certify that the loans on the trial balance agree to the loans in custody.
- (b) Verify that all pools are properly certified and report any pool past due for certification in accordance with Section 6-5, paragraph C.2.f. above.

D. Issuer's Administration Of Pooled Mortgages

1. Compliance Requirement. Administration of the pool of mortgages and of payments to securities holders is the responsibility of the issuer. Servicing of pooled mortgages must be carried out in accordance with generally accepted practices in the mortgage lending industry. Contractual requirements with respect to pool administration are contained in the guaranty agreement executed by the issuer and Ginnie Mae for each pool. The servicing system must be capable of producing at any time for any mortgage, an accounting which identifies the Ginnie Mae pool number for each listed mortgage, and for each monthly due date, the amount of each collection, disbursement, advance, or adjustment and indicating the latest outstanding balances of principal, deposits, advance and unapplied payments. In no instance may the issuer or subservicer remove a loan from a pool, reduce a loan balance or remove funds from a pool custodial account unless in compliance with the Ginnie Mae Guide and authorized by Ginnie Mae.

The issuer may incur losses for pooled loans that are not fully insured such as coinsured multifamily loans, manufactured housing loans and Department of Veterans Affairs (VA) guaranteed loans. For each of these loan types, should a foreclosure take place, the issuer may not be fully reimbursed through the claims process. Any shortfall in collections must be paid to the securities holder out of the issuer's own funds. These shortfalls have been particularly large in the VA program. Special attention should be given to issuers with a concentration of VA loans in declining market areas.

In the VA program, should a default occur, the VA will determine the cost effectiveness of bidding at the foreclosure sale. VA will not bid if its losses will exceed the guarantee amount. Consequently, this 'no-bid' will be costly to the issuer as it must pay off the security holder for the outstanding mortgage balance.

2. Suggested Audit Procedures
  - a. Test whether the issuer meets Ginnie Mae's requirement for separate custodial bank accounts for principal and interest collections (non-interest bearing) and tax and insurance escrow funds (option of interest bearing) applicable to pooled mortgages with the principal and interest accounts held in institutions meeting Ginnie Mae's rating requirements (All Participants Release, July 10, 1990). Test the custodial account titles for compliance with requirements established by Ginnie Mae Letter Agreements, Forms HUD-11709 and 11720. If a principal and interest disbursement clearing account is used, assure that it

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is used only for payments to Ginnie Mae securities holders. (NOTE: These accounts may contain funds for more than one pool provided that the issuer maintains separate accounting records for each pool).

- b. Review monthly collections of mortgage principal and interest and collections of claims on defaulted and liquidated mortgages to ascertain that funds have been deposited in the proper custodial accounts on a daily basis.
- c. Test whether the issuer is making payments of interest, principal, and unscheduled principal to securities holders by the 15th of the month. Test whether partial prepayments, prepayments in full, assignments, and foreclosures are passed through to the securities holders in the regular monthly payment following the month of receipt. Test that all such recoveries are recorded on Mortgage-Backed Securities report controls and the pool collateral is removed from the custodian's possession and the transaction is supported by documentation.
- d. Test whether disbursements from principal and interest custodial bank accounts are authorized pursuant to the Guaranty Agreement.
- e. Test whether the issuer is disbursing payments to Ginnie Mae I securities holders on a date that can be expected to result in receipt of the funds by the securities holders by the 15th of the month.
- f. Review a representative sample of payments to securities holders to determine that such payments were made to those shown in the securities holders register for the pools being tested.
- g. Compare mortgages listed in the issuer's Liquidation Schedule (Form HUD-11710E) to those identified on Form HUD-11708 held by the custodian as having been withdrawn from the pool to ensure proper pass-through of proceeds to securities holders.
- h. Test whether the issuer is using its own resources to:
  - (1) Make advances to the pool accounts to cover shortfalls in collections from mortgagors. (NOTE: Limited exceptions to this requirement are included in the Ginnie Mae Handbooks.) Special attention should be given to the issuer's calculation and use of excess funds, particularly for internal reserve pools.
  - (2) Cover principal amounts not recovered in claim settlements or which are due in connection with defective loans. (Issuers are required to "buy out" uninsured or otherwise defective loans from the pools in accordance with instruction in the Handbooks Ginnie Mae 5500.1 and 5500.2 using the issuer's own funds and only after receiving Ginnie Mae approval.)
- i. Obtain an understanding of the issuer's controls to project the need for and availability of funds. These controls should allow the issuer to make

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required advances to securities holders, as required under Section 4.02 of the Guaranty Agreement.

- j. Test whether the issuer incurred losses for pooled loans not fully insured such as coinsured multifamily loans, manufactured housing loans, and Department of Veterans Affairs guaranteed loans. Determine that the issuer has disclosed a contingent liability in the financial statements.
- k. Test that the issuer has a system to follow up on and obtain the required documents to enable the custodian to make its final certification in a timely manner. Ginnie Mae must receive the final certification, covering documents listed on the reverse side of the Schedule of Pooled Mortgages, within the timeframes identified in Handbooks Ginnie Mae 5500.1 and 5500.2.

If the issuer has acquired pools from another issuer, or if the issuer has transferred pools from one document custodian to another, test whether these pools have received new final certifications (recertification) within the timeframes outlined in the Ginnie Mae Handbooks.

- l. Test whether the issuer established a complete securities holders register in accordance with Ginnie Mae instructions and updated the register prior to paying holders each month. The register should include a record of all certificate transfers for the life of the pool.
- m. Test whether the issuer is servicing delinquent mortgages and managing foreclosures and assignments in accordance with the applicable requirements of the VA, FHA, RHS and the Ginnie Mae Guide.
- n. Test whether undelivered payments are deposited into the principal and interest custodial account and that checks which remain outstanding in excess of 6 months of the payment date are stopped and the funds are returned to the P&I custodial account. Undelivered payments should not be used as excess funds or used by the issuer to fund pool shortfalls.
- o. Test whether any transfer of the P&I or T&I custodial accounts, change of document custodian, change of mortgage servicer or transfer of issuer responsibility was accomplished after written approval from Ginnie Mae.

#### E. Review of Monthly Accounting Reports and Quarterly Submissions

- 1. Compliance Requirement. Ginnie Mae issuers of MBS are required to submit the following reports periodically throughout the year:
    - a. Form HUD-11710A, Form HUD-11710D and Form HUD-11710E  
 Issuers reporting: All Ginnie Mae issuers of record  
 Frequency of reporting: Monthly  
 Deadline for submission: 10th day of following month
    - b. Trial Loan Balance Information  
 Issuers reporting: All Ginnie Mae issuers of record
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Frequency of reporting: Quarterly  
 Deadline for submission: 45 days of end of calendar quarter

- c. Mortgage Bankers Quarterly Financial Reporting, Form HUD-11750  
 Issuers reporting: Mortgage bankers not federally regulated  
 Frequency of reporting: Quarterly  
 Deadline for submission: 60 days after end of calendar quarters and 90 days after end of calendar year
- d. Issuers must report to Ginnie Mae monthly on each pool. Such reports must be provided on Form HUD-11710A (Issuer's Monthly Accounting Report), Form HUD-11710E (Liquidation Schedule) and Form HUD-11710D (Issuer's Monthly Summary Report). Issuers with more than 100 pools (including Ginnie Mae I pools and Ginnie Mae II pools and loan packages) are required to report in electronic form using the procedures and format specified in Handbook 5500.1, Chapter 11.

Additional or alternative reports are required in connection with pools other than those for single family level payment loans, as explained in the chapters and appendices for the other programs.

The reports, along with supporting documents, must be sent to Ginnie Mae with sufficient lead time and via a method that ensures delivery no later than the tenth calendar day of each month. Instructions for the preparation and submission of the forms or magnetic tape are found in Appendices 11 through 14 of Handbook 5500.1.

- e. Issuers must report to Ginnie Mae quarterly on all of the loans in their portfolio. Loan level detail must be reported by all issuers every 3 months. The loan level data should report trial balance information for all non-liquidated loans as of the cut-off date for the quarter (All Participants Release, September 24, 1990).
- f. Issuers that are not federally regulated must report their financial condition quarterly to Ginnie Mae. Reports must be provided to Ginnie Mae on a pre-formatted disk, HUD-11750, which includes a Statement of Condition, Statement of Income and Additional Information. Federally regulated financial institutions (banks, savings and loans and credit unions) are not required to submit this report (All Participants Release, March 5, 1990).

## 2. Suggested Audit Procedures

- a. Obtain an understanding of the issuer's procedures for collecting and entering all data relating to mortgage collections and securities payments on Form HUD-11710A. Test whether entries are made in accordance with instructions in the Ginnie Mae Handbooks.
- b. Select a sample of Form HUD-11710A's and trace delinquency information to the issuer's internal mortgage servicing delinquency reports.

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- c. Compare the securities balance reported on the Form HUD-11710A to the Remaining Pool Balance (R.P.B.) reported to Ginnie Mae, or its agent, in accordance with Ginnie Mae MBS requirements.
  - d. Test whether a Liquidation Schedule (Form HUD-11710E) is submitted to Ginnie Mae for each loan removed from the pool. Also, test that the unpaid loan balances passed through to securities holders and reported in the Liquidation Schedule, agree to the issuer's records.
  - e. Compare the amount of checks sent to securities holders for the month to the amount reported to Ginnie Mae.
  - f. Compare the custodial account balances reported on Forms HUD-11710A and 11710D to the actual balances (after reconciliation) of the disbursement clearing and custodial bank accounts as shown by the bank statements.
  - g. On pools selected for review, reconcile the total unpaid principal balance of the pooled mortgages to the unpaid principal balance of the securities, as follows:
    - (1) Pool Principal Balance (Section 1, Line D, Form HUD-11710A)
    - (2) (plus) Prepaid Principal (Section 1, Line F)
    - (3) (minus) Delinquent Principal (Section 1, Line G)
    - (4) (minus) Concurrent Date (CD) Pools Only: Scheduled Principal (Section 1-A, Block C)
    - (5) (plus) CD Pools Only: Last Liquidation Principal Installment (Principal portion of last installment reported on Liquidation Schedule, Form HUD-11710E)
    - (6) (minus) CD Pools Only: Additional Principal Adjustment or FIC change for Graduated Payment Mortgage Pools (Section 2, Block D, Other)
    - (7) (equals) Security Principal Balance (Section 3, Line D)

Differences may arise in the reconciliation between the pooled loan balance and the outstanding securities balance due to additional principal payments or rounding. Such differences should not exceed \$1.00 for each loan in the pool up to a maximum of \$50.00 per pool. Any greater difference must be funded to the pool in the current report. At least once a year, adjustments to the securities holders payments must be made in Section 2, Block D, of Form HUD-11710A to fully correct for any difference. Reconcile and report on any difference.
  - h. For pools selected for review, test the expected Principal and Interest (P&I) Custodial Account balances at cut-off. This test (outlined below)
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identifies a minimum dollar amount expected in the P&I account for any particular pool as of a given cut-off date. This test verifies the accuracy of the P&I balance reported in Section 5, Block B2 of the Form HUD-11710A report. The test formula will only yield accurate results when the mortgage and securities balances reconcile in Step 7 above.

The test assumes that all collections are paid out by the pass through of funds to securities holders or taken as issuer servicing fees. The test formula is different between Internal Reserve (IR) and Concurrent Date (CD) pools, but in either case indicates the amount of P&I funds which should be held in the account at the cut-off date, which include:

- (1) (IR only) plus payment to securities holders, to be distributed on the 15th of the following month. (Form HUD-11710A, Section 2, Item G).
  - (2) (IR and CD) plus servicing fee, if taken after the cut-off date. If the issuer withdraws its servicing fee prior to the cutoff, this entry will be zero (Section 1, Item H).
  - (3) (IR and CD) plus prepaid P&I, funds which have been collected but are not required to be distributed to holders at the next payment date (Section 1, Item F, Total).
  - (4) (IR and CD) minus prepaid servicing fee, as calculated based on prepaid interest amounts (Section 1, Item F, Interest). Servicing fees collected on prepaid interest are already included in item (2) above.
  - (5) (IR and CD) minus delinquent P&I, funds not yet collected but which have already been distributed to holders through calculation of scheduled payment (Section 1, Item G, Total).
  - (6) (IR and CD) plus delinquent servicing fee as calculated based on total delinquent interest (Section 1, Item G, Interest). Servicing fees are not distributed to holders, so this amount is not a shortage in the account.
  - (7) (CD only) plus additional principal payments. These are funds collected but not due holders until the 15th of the following month (Section 1, Line B-2).
  - (8) (CD only) plus additional principal adjustment, the issuer-funded adjustment which has been deposited to the custodial account but is not distributed until the following month (Section 1, Line C, Pool Interest).
  - (9) (CD only) plus liquidation principal. Similarly, funds collected but not due to be distributed until the following month (Section 1, Item C).
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- (10) (CD only) plus fixed installment on liquidations, because it is necessary to amortize a liquidating loan through one payment beyond the month during which pay-off or foreclosure funds are received on CD pools. This “extra” month payment, normally not due until the following month, is included in the scheduled P&I amount.
  - (11) (CD only) minus servicing fee from liquidations, as calculated on the interest portion of the last payment installment (based on last interest installment on the Form HUD-11710E).

This calculated expected P&I balance should agree with the reported P&I balance (Form HUD-11710A, Section 5, B, 2). Differences should be reconciled and exceptions reported.

- i. Obtain an understanding of the issuer’s procedures and test whether the issuer meets the delivery requirement by the tenth calendar day of each month.
- j. Test that loan level information is being reported quarterly to Ginnie Mae.
- k. For all issuers that are not federally regulated financial institutions, test that quarterly financial information is being submitted on the HUD-11750, a formatted disk.

F. Securities Marketing and Trading Practices

- 1. Compliance Requirement. Ginnie Mae has established securities marketing and trading requirements which are intended to assure that issuers carry out their securities marketing and trading activities in a manner consistent with prudent business practices and their own and others financial capacity. There are three components to these requirements: (a) a suitability rule, (b) prudent business practice rules, and (c) minimum forward delivery contract requirements relating to so-called mark to market deposit requirements. There also are recordkeeping and reporting requirements. These procedures must be implemented by all approved issuers, whether or not securities and/or commitments are outstanding. The applicable requirements are found in HUD Handbook 5500.1.
  - 2. Suggested Audit Procedures
    - a. Obtain an understanding of the written procedures established by the issuer to determine the financial integrity of dealers, brokers, and investors, including an explanation of standards for, and steps taken in determining the financial capacity of dealers, brokers, or investors to complete transactions.
    - b. Test whether the issuer is following established procedures to determine the financial capacity of dealers, brokers, and
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investors to complete a transaction and to determine the business reputation of the dealers, brokers, and investors.

- c. Obtain copies of the resolution executed by the issuer's Board of Directors designating key persons responsible for overall supervision of issuer activities relating to the marketing and trading of securities.
  - d. Obtain an understanding of the procedures established by the issuer to maintain a record of all commitments entered into to deliver or acquire securities.
  - e. Test whether the issuer's records of such commitments include the following:
    - (1) Date of the transaction (trade date).
    - (2) Type of securities.
    - (3) Nature of the transaction: purchase, sale, optional or mandatory delivery, repurchase or other credit arrangement.
    - (4) Settlement date.
    - (5) Dollar amount of securities.
    - (6) Interest rate on the securities.
    - (7) "Price" of the securities.
    - (8) Name of the firm and individual with whom the transaction was executed.
    - (9) Current market price (value) of the contract.
  - f. For "regulated transactions" (see Note 1 at step h.) test whether the issuer's records include the following:
    - (1) A copy of the delayed delivery contract required by the Ginnie Mae Handbook.
    - (2) The name of the financial institution with which collateral is, or will be, deposited.
    - (3) Records of mark to market computations, including: market value, amounts of deposits by issuer and by contra-party, type of collateral deposited.
    - (4) If the collateral used is a letter of credit, a copy of the letter of credit.
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- g. Review the issuer's statement showing the computation of the issuer's "net position" and compare information to the issuer's accounting records. Prove the mathematical accuracy of the net position. The statement should identify amounts of loans and securities closed and held for sale, plus those expected to be acquired, less commitments the issuer has available for disposing of loans and securities. It also should include any positions involving repurchase, reverse-repurchase, or other credit transactions.
  - h. Determine the potential impact on an issuer's net worth of any identified forward or future commitment contract entered into by the issuer to purchase or sell securities, if there are material potential effects on the issuer's net worth, determine whether they are disclosed in the appropriate footnotes to the financial statements.

NOTE 1: "Regulated transaction" means the purchase or sale of securities by an issuer pursuant to a delay delivery contract except that the term does not include:

- (1) A sale of securities where: (1) the issuer holds a valid, outstanding commitment to guaranty mortgage-backed securities (which is not applied in connection with another transaction) issued by Ginnie Mae in an amount at least equal to the face amount of the securities sold; and (2) the settlement date under the contract is no later than the last day of the calendar month in which the 150th day after the contract's trade date falls.
- (2) A sale of securities guaranteed by Ginnie Mae and based on construction loans (construction loan securities) or project loans (project loan securities).
- (3) A sale or purchase of securities pursuant to a contract which does not obligate the issuer to actually sell/purchase securities, that is, a put or call transaction in which the issuer has the option to perform.
- (4) A purchase (or sale) of mortgage participation certificates directly from (or to) the Federal Home Loan Mortgage Corporation.

G. Adjusted Net Worth

- 1. Computation. A "Presentation of Adjusted Net Worth Calculation" is required for all issuers, even if there were no securities or commitments outstanding at fiscal year end. The required format for the "Presentation of Adjusted Net Worth Calculation" is provided on Attachment B of this Chapter.

Unacceptable assets are defined in Attachment A to this Chapter and should be itemized by asset classification. Do not aggregate the unacceptable assets into one line titled “Unacceptable Assets.”

If evidence exists indicating the existence of related party receivables which have not been deducted by the IA, Ginnie Mae will deduct the amount from the issuer’s adjusted net worth.

An issuer’s adjusted net worth will be calculated by subtracting the total amount of unacceptable assets from the net worth as stated on the IA audited balance sheet. Excess/(deficit) net worth is computed as the difference between adjusted net worth and required net worth.

Failure of the issuer to respond timely and satisfactorily to requests made by Ginnie Mae, or its agent, for additional information could result in disallowance of questionable assets and result in suspension or in termination of issuer status.

Where the Ginnie Mae issuer is a subsidiary, the adjusted net worth computation must focus exclusively on the assets and liabilities of the Ginnie Mae issuer.

2. Required Net Worth. Required Net Worth will be calculated as of the end of the issuer’s fiscal year as follows:
  - a. For issuers approved to securitize mortgage-backed securities pools backed by single family level payment, graduated payment, growing equity or adjustable rate mortgages, the net worth is: \$250,000 base net worth plus one percent of the amount of securities outstanding in excess of \$5 million, but less than \$20 million; plus 0.2 percent of any additional securities, commitment authority and total pools funded<sup>1</sup> in excess of \$20 million.
  - b. For issuers approved to securitize mortgage-backed securities pools backed by manufactured home loans, the net worth is: \$500,000 base net worth plus 0.2 percent of any additional securities, commitment authority and total pools funded in excess of \$35 million.
  - c. For issuers approved to securitize mortgage-backed securities pools backed by multifamily construction or permanent loans, the net worth is: \$500,000 base net worth plus 0.2 percent of any additional securities, commitment authority, total pools funded and dollar amount of unexpended construction loan draws<sup>2</sup> in excess of \$35 million.
  - d. The base net worth requirement for all issuer types will be indexed to inflation and adjusted every five years with a one year advance notice to issuers. The change in price index will be measured by the Consumer

<sup>1</sup>Pools that have been logged and are in the review process and the commitment line balance has been reduced.

<sup>2</sup>The net amount between Construction Loan commitment authority reserved and total Construction Loan draws made.

Price Index (CPI). The base net worth requirement may float downward subject to a \$250,000 or \$500,000 minimum depending upon an issuer's pool type eligibility. The adjusted base net worth will be rounded to the nearest thousand. The reference period from which inflation will be calculated is December 1995. The first adjustment of the base net worth requirement will be on January 1, 2002 which will reflect the change in price level during 1996 through 2000. Future adjustments will follow in this manner. The Ginnie Mae President shall have discretion to waive or lessen any increase or decrease given by the indexing formula.

ATTACHMENT A

## UNACCEPTABLE ASSETS FOR COMPUTATION OF ADJUSTED NET WORTH

1. Any asset or portion thereof pledged to secure obligations of another entity or any person. Supervised institutions that provide financial services to incorporated communities are sometimes required by State law to pledge their assets for the benefit of the community. These pledged assets are acceptable for supervised institutions only.
2. An asset due from an officer or stockholder of the mortgagee or from a related entity, except for:
  - o A construction loan receivable, secured by a first mortgage, from a related entity.
  - o A mortgage loan receivable established in the normal course of business in an arm's length transaction and secured by a first mortgage on the related property.
  - o A receivable from a related party where the affected parties have executed a cross-default agreement<sup>1</sup> or corporate guarantee agreement<sup>2</sup> with Ginnie Mae.
3. An investment in a related entity in which any officer or stockholder of the mortgagees has a personal interest<sup>3</sup> unrelated to that person's position as an officer or stockholder of the mortgagee.
4. That portion of an investment in a joint venture, subsidiary, affiliate, and/or other related entity, which is greater than equity, as adjusted. "Equity as adjusted" means the book value on the books of the related entity reduced by the amount of unacceptable assets carried by the related entity.
5. Any intangible asset, such as goodwill, covenants not to compete, franchise fees, organization costs, value placed on insurance renewals, and value placed on property management contract renewals.
6. The value of any servicing contract not determined in accordance with SFAS No. 65, Accounting for Certain Mortgage Banking Activities and SFAS No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, or subsequent revisions thereto.
7. Any asset not readily marketable and for which appraised values are very subjective. Examples include, but are not limited to, antiques, art work, and gemstones.

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<sup>1</sup>A cross default agreement is an agreement between related affiliated Ginnie Mae issuers which provides for the default of all affiliated issuers in the event of a default by any one of them.

<sup>2</sup>A corporate guarantee agreement is an agreement where the issuer's parent guarantees the performance of the issuer.

<sup>3</sup>"Personal interest" as used here indicated a relationship between the mortgagee and a person or entity in which that specified person (e.g. spouse, parent, grandparent, child, brother, sister, aunt, uncle, or in-law) has a financial interest in or is employed in a management position by the mortgagee.

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8. That portion of any marketable security (listed or unlisted) in excess of the lower of cost or market, except for shares of Fannie Mae stock required to be held under a servicing agreement, which should be carried at cost.
  9. Any amount in excess of the lower of cost or market value of mortgages in foreclosure, construction loans, or property acquired through foreclosure.
  10. Any asset which is principally used<sup>1</sup> for the personal enjoyment or benefit of an officer, director, or stockholder and not for normal business purposes. This includes automobiles and personal residences.
  11. “Other Assets” unless the financial statements are accompanied by a schedule prepared by the independent auditor or a schedule prepared by the issuer/mortgagee and signed by an officer of the issuer/mortgagee.
  12. That portion of contributed property, not otherwise excluded, in excess of the value as of the date of contribution determined by an independent appraisal.

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<sup>1</sup>“Principally used” means that any other use of the property must be solely incidental.

ATTACHMENT B

REQUIRED FORMAT FOR PRESENTATION OF ADJUSTED NET WORTH  
CALCULATION FOR ISSUER

A. Adjusted Net Worth Calculation:

Stockholders Equity per Statement  
of Financial Condition at end of  
reporting period \$ \_\_\_\_\_

Less:

Itemized Unacceptable Assets<sup>1/</sup>

1. \$ \_\_\_\_\_

2. \$ \_\_\_\_\_

3. \$ \_\_\_\_\_

Total Unacceptable Assets \$ \_\_\_\_\_

Adjusted Net Worth \$ \_\_\_\_\_

B. Required Net Worth Calculation:

Unpaid Principal Balance of  
Securities Outstanding  
(Note: Number of Pools \_\_) \$ \_\_\_\_\_

Plus:

Outstanding Balance of  
Commitments Authority Issued  
and Requested \$ \_\_\_\_\_

Total Outstanding Portfolio  
and Authority \$ \_\_\_\_\_

Required Net Worth \$ \_\_\_\_\_

C. Excess (Deficit) Net Worth \$ \_\_\_\_\_<sup>2/</sup>  
(Adjusted Net Worth - Required Net Worth)

<sup>1/</sup> Unacceptable assets are defined in Attachment A.

<sup>2/</sup> In the event adjusted net worth does not meet the Ginnie Mae requirement, the IA may include any comments from representatives of the issuer of corrective measures contemplated.



ATTACHMENT C

REQUIRED FORMAT FOR PRESENTATION OF ADJUSTED NET WORTH  
CALCULATION FOR ISSUER'S PARENT

A. Adjusted Net Worth Calculation:

Stockholders Equity per Statement  
of Financial Condition at end of  
reporting period \$ \_\_\_\_\_

Less:

Itemized Unacceptable Assets<sup>1/</sup>

1. \$ \_\_\_\_\_

2. \$ \_\_\_\_\_

3. \$ \_\_\_\_\_

Total Unacceptable Assets \$ \_\_\_\_\_

Adjusted Net Worth \$ \_\_\_\_\_

B. Comparison of Net Worth Calculations:

Issuer's Required Net Worth  
(taken from Issuer's Adjusted  
Net Worth Calculation) \$ \_\_\_\_\_

(Multiply issuer's required net  
worth by 110% for issuers with  
single family status only, otherwise  
multiply by 120%)

Parent's Required Net Worth \$ \_\_\_\_\_

C. Excess/(Deficit): \$ \_\_\_\_\_

<sup>1/</sup> Unacceptable assets are defined in Attachment A.

ATTACHMENT D

## REQUIRED FORMAT FOR PRESENTATION OF INSURANCE REQUIREMENT

A. Identification of Affiliated<sup>1/</sup> Ginnie Mae Issuers:

Affiliated Ginnie Mae Issuers:  
(Issuer Name and Ginnie Mae Issuer Identification  
Number)

Affiliated Issuers on Same Insurance Policies:  
(Issuer Name and Ginnie Mae Issuer Identification  
Number)

B. Required Insurance Calculation:

Servicing Portfolio:		
Ginnie Mae	\$ _____	
Fannie Mae	\$ _____	
Freddie Mac	\$ _____	
Conventional (Other)		\$ _____
Total Servicing Portfolio		\$ _____
Required Fidelity Bond Coverage		\$ _____
Required Mortgage Servicing Errors and Omissions Coverage		\$ _____

C. Verification of Insurance Coverage:

Fidelity Bond Coverage at End of Reporting Period	\$ _____
Mortgage Servicing Errors and Omissions Coverage at End of Reporting Period	\$ _____

D. Excess (Deficit) Insurance Coverage:

Fidelity Bond Coverage	\$ _____
Required Mortgage Servicing Errors and Omissions Coverage	\$ _____

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E. Ginnie Mae Loss Payable Endorsement:

Fidelity Bond Coverage

\$ Yes/No

Mortgage Servicing Errors and  
Omissions Coverage \$ Yes/No

<sup>1/</sup> Definition of an Affiliate: An affiliate is a party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with an issuer.

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ATTACHMENT E

REPORT OF INDEPENDENT AUDITORS ON CONSOLIDATING BALANCE SHEET AND  
STATEMENT OF INCOME

Board of Directors  
ABC Financial Corporation

We have audited, in accordance with generally accepted auditing standards and Government Auditing Standards, the consolidated financial statements of ABC Financial Corporation and subsidiaries as of December 31, 1991 and have issued our unqualified opinion thereon dated January 24, 1992 included on page "XX" of [identify report]. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The following consolidating balance sheet and statement of income on pages "XX" and "XX," respectively, are presented for purposes of additional analysis and are not a required part of the consolidated financial statements of ABC Financial Corporation and subsidiaries. Such information has been subjected to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

This report is intended for the information of the audit committee, management, and the Government National Mortgage Association (Ginnie Mae). However, this report is a matter of public record and its distribution is not limited.

[Firm Signature]

[Date]

ATTACHMENT F

REQUIRED TRANSMITTAL/CHECKLIST FOR ANNUAL SUBMISSION OF  
FINANCIAL DOCUMENTS

Address to: Ginnie Mae's Review Agent

To whom it may concern:

The following information is being sent to maintain eligibility in the Mortgage-Backed Securities Program. If you have any questions regarding the items being sent, you may contact Mr./Ms.

\_\_\_\_\_ of the organization or me at telephone number  
\_\_\_\_\_. Our facsimile number is \_\_\_\_\_.

Complete Items 1 through 7

1. Issuer Name: \_\_\_\_\_
2. Issuer Address: \_\_\_\_\_
3. Issuer's Tax Identification No. \_\_\_\_\_
4. Ginnie Mae I.D. No. \_\_\_\_\_
5. FHA Mortgagee No. \_\_\_\_\_
6. IA's Tax Identification No. \_\_\_\_\_
7. IA's Contact Person \_\_\_\_\_  
and Telephone Number: \_\_\_\_\_

Place a Checkmark by Item(s) Submitted

1. \_\_\_ Annual Audited Financial Statement for period ended \_\_\_/\_\_\_/\_\_\_
2. \_\_\_ IA's Report on Consolidating Balance Sheet and Statement of  
Income (if appropriate)
3. \_\_\_ IA's Report on Internal Controls
4. \_\_\_ IA's Report on Compliance with specific Requirements
5. \_\_\_ IA's Presentation of Insurance Requirement
6. \_\_\_ IA's Presentation of Adjusted Net Worth for Issuer
7. \_\_\_ IA's Presentation of Adjusted Net Worth for Parent, (if appropriate)
8. \_\_\_ Corrective Action Plan (if appropriate)
9. \_\_\_ Schedule of "Other Assets"
10. \_\_\_ Name, address and Ginnie Mae Issuer Number (if applicable)  
of all affiliates. An "affiliate" is defined for these purposes as an organization that is related to the  
issuer through some type of control or ownership (as defined by GAAP). Use additional page if  
necessary:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Signature: \_\_\_\_\_ Date: \_\_\_\_\_

Type of Print Signature Name: \_\_\_\_\_

Title: \_\_\_\_\_